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# Living with a PPP Loan - Part 2:

## *Navigating the Loan Forgiveness Application*

Mark A. Limardo  
[mlimardo@olshanlaw.com](mailto:mlimardo@olshanlaw.com)  
212.451.2364  
[www.olshanlaw.com](http://www.olshanlaw.com)

Michael J. Passarella  
[mpassarella@olshanlaw.com](mailto:mpassarella@olshanlaw.com)  
212.451.2322  
[www.olshanlaw.com](http://www.olshanlaw.com)

## Program Agenda

With the SBA's recent release of the Loan Forgiveness Application (SBA Form 3508) ("**LFA**"), we have some additional insight into the following questions:

- What expenses can I pay with the PPP loan proceeds and how fast do I need to pay them?
- How do I maximize PPP loan forgiveness?
- What is the process for getting PPP loan forgiveness?
- Are there any obligations in the PPP loan documents that will affect my business?
- Will my PPP loan be subject to agency review?

Note: Many aspects of the PPP loan life cycle lack guidance or, even with guidance, remain ambiguous. Where necessary, we have made judgment calls in the absence of clear guidance.

## Regulatory and Legislative Update

### Another Interim Final Rule – Loan Forgiveness

<https://home.treasury.gov/system/files/136/PPP-IFR-Loan-Forgiveness.pdf>

### Legislative Relief

Given the challenges of the current business environment, bi-partisan political momentum is building for new legislation, including:

- House Bill (H.R. 6886): extending the period during which PPP loan proceeds must be spent (the “8-Week Period” in Q&A-1) to the earlier of (a) 24 weeks or (b) December 31, 2020, and eliminating the requirement that at least 75 % of PPP loan proceeds must be spent on Payroll Costs (as defined in Q&A-3) to obtain loan forgiveness.
- Senate Bill (S. 3833): extending the deadline to apply for the PPP loan to December 31, 2020, and the 8-Week Period to 16 weeks.

## Resource Guide

### **Federal and State Responses to COVID-19: Source Materials and Practical Advice**

<https://www.olshanlaw.com/blogs-covid-19-legal-resources,federal-and-state-responses-to-covid-19>

## **Q1: For what and how fast must a borrower spend PPP loan proceeds?**

**A1**: PPP loan proceeds must be used to pay payroll and certain other qualifying costs (Permitted Payments as discussed in Q&A-2) during the eight-week period beginning on the date of the ***first disbursement*** made under a PPP loan (the ***“8-Week Period”***).

**Note 1**: For loan forgiveness, the 8-Week Period equals 56 days.

**Note 2**: For loan forgiveness, employers with bi-weekly or more frequent pay periods can use an alternate start date – the first day of the first pay period following the first loan disbursement date.

## Q2: What expenses can I pay with loan proceeds during the 8-Week Period?

A2: During the 8-Week Period, PPP loan proceeds can be used to pay the following payments (the “**Permitted Payments**”):

- cash compensation to W-2 employees (U.S. only), such as salary, bonus, severance, vacation and sick leave pay and tips (\$15,385/employee cap),
- W-2 employee benefits, such as health care expenses and retirement contributions (no cap),
- state payroll taxes, such as state unemployment insurance (no cap),
- rent on leases (real or personal property) (25% cap),
- utilities (25% cap), and
- interest on any secured debt and any unsecured debt incurred before 2/15/20 (25% cap).

## Q3: Is there a minimum amount I must use to pay Payroll Costs?

A3: Yes. Under SBA guidance, at least 75% of PPP loan proceeds must be used for “Payroll Costs.” No more than 25% of a PPP loan may be used to pay rent, interest, and utilities. However, LFA seems to indicate otherwise.

“**Payroll Costs**” means cash compensation paid to U.S. employees (*e.g.*, salary, commissions, and tips), leave-related pay (*e.g.*, vacation and parental, family, medical, or sick leave), severance, employee benefits consisting of group health care coverage and retirement benefits, and state and local employment taxes.

Note 1: In determining Payroll Costs, the \$15,385 per employee cap applies to cash compensation only (as noted in Q&A-2), not employee benefits.

Note 2: Cash compensation exceeding the per-employee cap is excluded from Payroll Costs, resulting in a **non-permitted use** and limited loan forgiveness.

## **Q4: Are distributions to LLC members (or partners) treated as “Payroll Costs?”**

**A4**: Yes. However, Payroll Costs for an LLC member are capped at the lesser of (a) \$15,385 or (b) the product of (1) 8/52 and (2) the LLC member’s 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.

**Note**: S corporation dividends do not count as Payroll Costs.



## **Q5: When are Payroll Costs considered to be paid?**

**A5:** A Payroll Cost is considered paid when an employer distributes a physical pay check or initiates an ACH credit transaction.

## **Q6: Can I use PPP loan proceeds for Permitted Payments that are past due?**

**A6**: PPP loan proceeds can be used to pay Permitted Payments during the 8-Week Period, even if those Permitted Payments are past due or arose prior to the 8-Week Period.

**Note**: Payment of a past-due or previously-accrued Permitted Payment should also count as a Forgiveness Payment (as defined in Q&A-14), which reduces the portion of a PPP loan that must be repaid.

## **Q7: Can I use PPP loan proceeds to pre-pay Permitted Payments?**

**A7**: PPP loan proceeds can be used to pre-pay Permitted Payments, except for interest.

## **Q8: Can I use PPP loan proceeds to pay a Permitted Payment after the 8-Week Period?**

**A8**: If a borrower incurs a cost during the 8-Week Period that would otherwise be a Permitted Payment if paid during the 8-Week Period, the payment of the cost counts as a Permitted Payment if paid on or before:

- in the case of Payroll Costs: the first regular payroll date occurring after the close of the 8-Week Period, and
- in the case of non-payroll costs: the first regular billing date occurring after the close of the 8-Week Period.

**Note**: In the absence of additional guidance, a borrower should apply GAAP to determine whether it has incurred a cost during the 8-Week Period.

## **Q9: What happens if I can't spend at least 75% of my loan proceeds on Payroll Costs?**

**A9**: If a borrower does not spend the required 75% minimum on Payroll Costs during the 8-Week Period, the shortfall cannot be used for any other purpose and must be immediately repaid (and also does not count towards loan forgiveness).

**Note**: Many loan documents do not properly reflect SBA guidance on this required minimum use of PPP loan proceeds for Payroll Costs. Instead, some loan documents allow borrowers to use less than the required 75% (without requiring repayment) and reduce loan forgiveness by the shortfall in Payroll Costs. However, LFA seems to indicate that this may not be the result.

## **Q10: What happens if I can't spend all loan proceeds on Permitted Payments during the 8-Week Period?**

**A10**: If a borrower does not spend all PPP loan proceeds during the 8-Week Period, the CARES Act seems to imply that the unspent proceeds cannot be used at all and must be immediately repaid (and also does not count towards loan forgiveness). The LFA seems to hint at a different outcome – spending outside the 8-Week Period is permitted but is not eligible for loan forgiveness.

**Note**: Loan documents can differ on this point, with some treating the tardy expenditure of the loan proceeds as an unauthorized use while others allow the tardy use but reduce loan forgiveness by payments made after the 8-Week Period.

## **Q11: What is the “loan forgiveness” process and how long does it take?**

**A11**: A borrower must submit an application (SBA Form 3508) for loan forgiveness to the lender (60-day review). After reviewing the application, the lender forwards the loan forgiveness application to the SBA for final approval (90-day review).

## **Q12: When do I have to file my application for loan forgiveness?**

**A12**: There is no specific deadline for filing the LFA. If a PPP loan goes into payment mode, a borrower can recover any payments made on the PPP loan through the loan forgiveness process.



## **Q13: What is the general rule for calculating loan forgiveness?**

**A13**: PPP loan principal is canceled to the extent of Forgiveness Payments (Q&A-14) made or costs incurred during the 8-Week Period, subject to adjustments for headcount and wage reduction.

**Note 1**: Not all Permitted Payments count as Forgiveness Payments.

**Note 2**: Forgiveness Payments may be reduced for lay-offs and wage reductions.

**Note 3**: A borrower pays no income tax on loan forgiveness income but cannot claim deductions for Forgiveness Payments.

## Q14: What expenses paid during the 8-Week Period count towards loan forgiveness?

A14: The following amounts paid or incurred during the 8-Week Period (“*Forgiveness Payments*”) count towards PPP Loan forgiveness:

- cash payments to W-2 U.S. employees , such as salary, bonus and tips (\$15,385 per employee cap),
- W-2 employee benefits, such health care expenses and retirement contributions (no cap),
- state payroll taxes, such as state unemployment insurance (no cap),
- rent on leases (real or personal property) dated before 2/15/20 (25% cap),
- utilities under service agreements dated before 2/15/20 (25% cap), and
- interest on secured (real or personal property) debt incurred before 2/15/20 (25% cap).

## Q15: Do wage decreases reduce Forgiveness Payments?

A15: Yes. If an employee making \$100,000 or less suffers a wage decrease of more than 25% during the 8-Week Period (as compared to the last full calendar quarter prior to the 8-Week Period), the excess wage reduction for the 8-Week Period reduces the amount of the Forgiveness Payments.

Note 1: Up to 25% of any wage reduction is “free” and does not reduce Forgiveness Payments (*i.e.*, no “first dollar” reduction). No wage reduction for a highly-compensated employee counts against Forgiveness Payments.

Note 2: LFA refers to this as the ***Salary/Hour Wage Reduction*** on Line 5 of the PPP Loan Forgiveness Calculation Form.

## Q16: How is the *Salary/Hour Wage Reduction* calculated?

A16: An employee's annual salary during the 8-Week Period is compared to the employee's annual salary during the first quarter of 2020.

*Example*: Employee X is paid at an annual rate of \$50,000 during the first quarter and at an annual rate of \$30,000 during the 8-Week Period.

Step 1:  $50,000 * .75 = 37,500$  (75 percent threshold)

Step 2:  $37,500 - 30,000 = 7,500$  (Gross salary reduction)

Step 3:  $7,500 * (8/52) = 1,154$  (Pro-rated salary reduction)

Step 4: Subtract Step 3 result from Forgiveness Payments (before the full time equivalent ("**FTE**") reduction adjustment).

## Q17: Do lay-offs reduce PPP loan forgiveness?

A17: Yes. Forgiveness Payments are scaled back in proportion to any workforce reduction (unless the borrower restores employment to pre-reduction in force levels by June 30, 2020).

Note: A borrower can terminate independent contractors without any reduction in Forgiveness Payments.

## Q18: How do lay-offs reduce Forgiveness Payments?

A18: Forgiveness Payments are reduced proportionately, by dividing (a) the average number of full-time equivalent employees during the 8-Week Period by (b) the average number of full-time equivalent employees during one of two alternative base periods (as chosen by the borrower, the 2/15 - 6/20/19 period or the 1/1 - 2/29/20 period).

Note: LFA refers to the above ratio as the ***FTE Reduction Quotient*** on Line 7 of the PPP Loan Forgiveness Calculation Form.

*Example*: Borrower has a 75 FTEs during the 8-Week Period and 100 FTEs during both of the two alternative base periods. The borrowers FTE Reduction Quotient is .75.

## **Q19: How does a borrower count an FTE number for a single employee?**

**A19**: While the LFA provides additional guidance on how to determine FTE status, the calculation still remains unclear.

**Actual Method**: Take average hours worked per week for each and divide by 40 (capped at 1).

*Example*: Employee X works two weeks during the Covered Period, logging 35 hours in Week 1 and 40 hours in Week 2. Employee X is .94 FTE  $[35+40/2$  and then divided by 40].

**Simplified Method**: Same as above, except that all employees below 1 go in at .5

## **Q20: How does a borrower determine total FTEs for a period?**

**A20**: Take the sum of FTEs of all employees (as calculated in accordance with Q&A-19).



## **Q21: Does employee hiring or restoring wages avoid loss of Forgiveness Payments?**

**A21**: Yes, if the employer restores headcount or the reduced wages by June 30, 2020, but only if the lay-offs or wage reductions occurred during the period beginning on February 15, 2020, and ending on April 26, 2020.

## **Q22: What if a laid-off employee refuses to come back to work by June 30?**

**A22**: A borrower can include as a FTE an employee who refuses to return to work, if:

- during the 8-Week Period, the borrower makes a good faith, written offer to the employee on the same terms in effect in the employee's last pay period prior to the separation,
- the offer is rejected by such employee,
- the borrower maintains records documenting the offer and its rejection, and
- the borrower informs the applicable state unemployment insurance office of such employee's rejected offer of reemployment within 30 days of the employee's rejection of the offer.

## Q23: What is the order of operations for loan forgiveness?

### A23:

Step 1: For the 8-Week Period, determine total Forgiveness Payments (subject to caps).

Step 2: For employees employed during the 8-Week Period, determine wage reduction amount in accordance with Q&A-15 and Q&A-16.

Step 3 (Salary Reduction Adjustment): Subtract Step 2 from Step 1.

Step 4: For the 8-Week Period, calculate total FTEs, including FTEs from rehiring cure rule (in Q&A-21) and rejected offer rule (in Q&A-22).

Step 5: For either (a) 1/1 to 2/29/20 or (b) 2/15 to 6/30/19, calculate total FTEs. **Take the lower FTE result.**

Step 6 : Divide Step 4 FTE result by Step 5 FTE result.

Step 7 (FTE Reduction Adjustment): Multiply Step 3 result by Step 6 result.

Step 8: Take lesser of (a) Step 7 result and (b) total Payroll Costs for 8-Week Period divided by .75.

Step 9: Subtract Step 8 result from PPP loan principal. **Remaining principal must be repaid.**

## Q23(A): Can we see a numerical example?

A23(A): Sure !

*Assumptions.* (A) PPP Loan Amount - \$100K, (B) Usage – \$70K on Payroll Costs and \$30K on rent, (C) Salary/Hourly Wage Reduction – \$1.5K (Q&A - 16), and (D) FTE Reduction Quotient - .75 (Q&A-18):

\$100K (B) MINUS \$1.5K (C) = \$98.5

\$98.5K TIMES .75 (D) = \$73.9K

Take lesser of \$73.9K and \$93.33K {Payroll Costs divided by .75}.

\$100K - \$73.9K = \$26.1K. ***Remaining principal must be repaid.***

## **Q24: Do the PPP loan documents put any restrictions on how I run my business?**

**A24**: Yes. While a PPP loan remains outstanding, most loan documents prohibit the borrower from:

- making any changes to its ownership or business structure (including through a merger or other similar transaction),
- making a distribution to an equity owner if the distribution would adversely affect the borrower's financial condition, and
- transferring (including by pledge) or disposing of any assets except in the ordinary course of business.

## Q25: How aggressively is the SBA reviewing PPP loans?

A25: As part of the loan forgiveness process, the SBA has announced its intention to review every PPP loan over \$2 million and says it will review smaller loans as appropriate. The LFA requires the borrower to disclose if the borrower, together with its affiliates, have taken PPP loans in excess of this limit.

**For further information please contact:**



**Mark A. Limardo**

**[mlimardo@olshanlaw.com](mailto:mlimardo@olshanlaw.com)**

**212.451.2364**



**Michael J. Passarella**

**[mpassarella@olshanlaw.com](mailto:mpassarella@olshanlaw.com)**

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